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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Pay Telephone	)	CC Docket No. 96-128
Reclassification and Compensation	)	
Provisions of the Telecommunications	)	
Act of 1996	)	

COMMENTS OF MIDCOM COMMUNICATIONS INC.
ON ISSUES RELATED TO COURT REMAND

MIDCOM Communications Inc. ("MIDCOM") hereby submits its Comments in response to the Commission's Public Notice[1] which seeks comments on issues raised by the D.C. Circuit's remand of the pay phone compensation orders.[2] As a mid-tier interexchange carrier that does not provide pay phone services, MIDCOM is a payor of compensation but not a recipient. As such, MIDCOM is interested in ensuring that pay phone service providers ("PSPs") are fairly compensated, as required by section 276 of the Act, without being overcompensated. The record previously filed in this proceeding demonstrates that the compensation rate for toll-free calls and access code calls should not be based on the local coin rate; that this compensation rate should be reduced from $0.35; and that the pay phone

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[1] "Pleading Cycle Established for Comment on Remand Issues in the Pay Phone Proceeding," DA 97-1673, released Aug. 5, 1997.

[2] Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128, Report and Order, FCC 96-388 (rel. Sept. 20 1996) ("*Pay phone Order*"); Order on Reconsideration, FCC 96-439 (rel. Nov. 8, 1996 ("*Order on Reconsideration*") (collectively, "*Pay phone Orders*"); remanded *sub nom. Illinois Public Telecommunications Assn. v. FCC and United States*, Case No. 96-1394 (D.C. Cir., July 1, 1997).

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compensation obligation should be allocated among payors on the basis of actual pay phone revenues for these types of calls rather than total toll revenues.

I. THE COMPENSATION RATE FOR TOLL-FREE CALLS AND ACCESS CODE CALLS SHOULD NOT BE BASED ON THE LOCAL COIN RATE

In the underlying proceeding, the FCC sought a market-based pay phone rate that could be used as a surrogate for compensation of calls placed from pay phones.[3/] The FCC selected a rate of $0.35, which it found was the prevailing local coin rate in four of the five states that had deregulated provision of pay phone services.[4/] This rate was to be the default rate for permanent compensation, as well as the per-call amount during the second year of the interim period.[5/] The Commission also used this surrogate rate to calculate the carriers' flat rate obligations for the first year of interim compensation.[6/] The court remanded this modal rate for both the interim and permanent periods as applied to toll-free (800, 888) calls and access code calls placed from pay

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3/ Pay Phone Order at ¶ 70.

4/ The Commission used local coin rates in Iowa, Nebraska, North Dakota and Wyoming when determining the base local coin rate. In the other deregulated state, South Dakota, the local coin rate was $0.25. Pay Phone Order at ¶ 56, *citing Ex Parte* Letter from Michael Kellogg, Counsel for RBOCs, to William Caton, FCC, dated Aug. 30, 1996..

5/ The Commission established a two-year interim plan. During the first year, IXCs were to pay the PSPs a flat compensation rate of $45.85 per pay phone per month, allocated among the IXCs according to their annual total toll revenues. During the second year, IXCs were required to pay the rate of $0.35 per call. The FCC intended this rate to be a default rate, although the PSPs and IXCs would be free to negotiate a different rate. Pay Phone Order at ¶71-72; Pay Phone Reconsideration Order at ¶ 71.

6/ Pay Phone Order at ¶ 122. Thus, if the Commission changes the $0.35 surrogate, the flat-rate obligation which was premised on the surrogate would also need to be recalculated.

phones because the Commission had failed to justify setting the rates for these obviously different services based on the rate for local coin calls.[7]

The Commission now has asked for comments on whether the local coin rate is the appropriate basis for toll-free calls and access code calls. Specifically, the Commission is interested in: (1) whether the costs incurred by PSPs in originating subscriber 800 calls and access code calls are different than the costs incurred in providing local coin calls; (2) how these cost differences should affect a market-based compensation amount; and (3) whether it would be appropriate to use, as the compensation rate for subscriber 800 calls and access code calls, the local coin rate, minus an offset for the expenses that are incurred only in providing local coin calls. The Commission also sought comment on additional questions with respect to the interim compensation plan, including whether annual toll revenues are the appropriate basis for

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[7] Indeed, the court stated

> The problem with the FCC's decision is that the record in this case is replete with evidence that the costs of local coin calls versus 800 and access code calls are *not* similar. Numerous IXCs pointed out that the costs of coin calls are higher than those for coinless calls because of the costs typically associated with use of coin equipment (*e.g.*, the costs of purchasing the equipment and coin collection). In addition, IXCs showed that costs of local coin calls are higher because the PSP bears the costs of originating *and* completing local calls (*i.e.*, the 'end-to-end' costs); by contrast, for coinless calls, the PSP only bears the costs of *originating* the calls. Even APCC, a trade group for independent PSPs, acknowledged that the costs of coin calls are higher than those of coinless calls.
>
> The FCC failed to respond to any of the data showing that the costs of different types of pay phone calls are not similar....

Slip Op. at 14-15 (emphasis in original); (internal citations omitted).

allocating flat-rate compensation obligations among all IXCs, and whether it should include LECs that carry toll traffic among carriers required to pay interim compensation. MIDCOM addresses these issues below.[8/]

A. The Local Coin Rate Is an Inappropriate Mechanism for Setting Rates for 800 Calls and Access Code Calls

Using a market-based rate approach to establish pay phone compensation is flawed for several reasons. First, the pay phone market is not yet competitive.[9/] Even though the pay phone market is open to competition in theory, the fact is that the majority of pay phone locations are already subject to contracts between the location owners and the LECs or independent PSPs.[10/] This is especially true for the most profitable locations since those locations would be the most interesting for any provider entering the market.[11/] Thus, it will take some years for these pay

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[8/] The court also remanded the Commission's decision not to require compensation for 0+ calls and calls made from prison pay phones. MIDCOM has not addressed those types of calls in its comments.

[9/] As mentioned above, the Commission has devised an interim plan with a two-year calendar. The fact that the pay phone market is not yet competitive calls into question the timeframe for implementation of the permanent compensation rate. MIDCOM recommends that the second phase of the interim compensation plan -- *i.e.*, per-call compensation based on the Commission-determined rate -- should remain in place until the Commission has made an affirmative determination that the pay phone market is competitive.

[10/] The Commission noted that the RBOCs have between 60 percent and 80 percent of the pay phone units in their respective regions. Pay Phone Order at ¶ 216.

[11/] BellSouth acknowledged this fact when it asserted that market share measurements based on percentages are misleading because a large portion of the RBOC pay phones are non-competitive or semi-public pay phones which produce below-market-level revenues. BellSouth, Reply Comments at 3-4 (filed July 15, 1996). Indeed, the Commission's designation of so-called public interest pay phones shows that there are economically less desirable locations where market forces do not lead to competition among PSPs. Pay Phone Order at ¶ 264 ("we recognize the potential that a freely competitive marketplace may not provide for pay phones in locations where they serve important public policy objectives but phone contracts to be open for renegotiation to any new providers of pay phone services.[12] Renegotiation of contracts is a prerequisite for truly open competition among PSPs. Until renegotiation of a substantial percentage of contracts has occurred, it is premature to deem this market competitive.

Second, four of the five states the Commission used to set the default rate are largely rural and therefore are not representative of the rate that would be set nationwide in a competitive market.[13] Pay phones located in isolated, rural areas are not subject to active competition among PSPs as are pay phones located in busy, urban areas. Because these pay phones do not experience the level of traffic experienced by pay phones located in high-traffic urban areas, they are not subject to the usual market forces. As such the prices charged at these phones are higher than a rate that would be established using a nationwide average of competitive pay phones.[14]

Third, as the court properly recognized, the costs incurred by PSPs are greater for local coin calls than for calls placed through toll-free numbers or access codes. Consequently, the

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which, for various reasons, may not be economically self-supporting").

[12] Even when those contracts come due for renegotiation, the process may not be fully competitive, as shown in the Commission's recent decision regarding the Huntington Park, California contracts. *California Pay Phone Ass'n Petition for Preemption of Ordinance No. 576*, Memorandum Opinion and Order, FCC 97-251, released July 17, 1997 (Pacific Bell was allowed to retain the pay phones already installed on the city's public rights-of-way and was permitted to install additional pay phones, subject to city approval).

[13] *See supra* note 4. Indeed, the state whose rate the Commission rejected (South Dakota) has a market-based rate of $0.25.

[14] Up to this moment, the PSPs have not cooperated in placing cost information in the record so that the Commission could determine the truly competitive rate. Their lack of cooperation does not obviate the need for this information.

rates for local coin calls are higher than rates should be for toll-free calls and access code calls. The PSPs set their local coin rates to recover for both origination and termination of the calls, while non-coin calls need to collect only for origination of the calls.[15] Local coin rates also must recover the costs of the coin mechanism on the pay phone, the coin signalling capabilities to monitor minutes of use, and the physical collection of coins deposited into the pay phones.[16] Non-coin calls need not collect for the coin mechanism or the coin monitoring or any billing functions since the IXC bears the cost of billing the customer.

Therefore, the so-called market rate for local coin calls in four predominantly rural states is not a reliable indicator of what the rate should be for access code calls and toll-free calls placed from pay phones. As a result, the Commission cannot rely on this local coin surrogate in establishing a compensation rate for toll-free and access code calls. A recalculation of the rate is necessary to reflect the obvious differences.

B. If the Commission Persists in Using the Coin Rate as a Surrogate, It Must Reduce the Rate To Account for the Lower Cost of Providing Toll-Free and Access Code Calls

Given the court's remand of the default rate, the Commission must determine a rate that more closely approximates the costs of providing toll-free calls and access code calls. The court was convinced that the $0.35 compensation rate selected by the Commission appeared to over-

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15/ *See e.g.*, AT&T Corp., Reply Comments at 12-13 (filed July 15, 1996); Sprint Corp., Comments at 9 (filed July 1, 1996).

16/ *See e.g.*, Sprint Comments at 9; AT&T Reply Comments at 6; Cable & Wireless, Inc., Petition for Reconsideration at 5-6 (filed Oct. 21, 1996); WorldCom, Inc., Petition for Reconsideration at 8-9 (filed Oct. 21, 1996).

compensate the PSPs and that a review followed by a reduced rate was necessary.[17] During the underlying proceeding, Sprint submitted information indicating the cost for PSPs to provide these calls is $0.067.[18] AT&T noted that Sprint and AT&T currently pay the Regional Bell Operating Companies that provide pay phone services a rate of $0.25 per call for dial-around calls, but it estimated that the cost of providing these calls is "a fraction" of that rate.[19] Based on this record evidence alone, the Commission should reduce the pay phone compensation to a rate between the range of $0.067 and $0.25.

As indicated in the Public Notice, one option to replace the local-coin-surrogate approach would be to start with the surrogate local coin rate, but to subtract an offset for the expenses that are incurred only in providing local coin calls, to arrive at the compensation rate for subscriber 800 calls and access code calls. Although MIDCOM is more than willing to assist the Commission in such a determination, it is unfortunately not in a position to provide specific costs as it does not provide pay phone services. MIDCOM recommends that the Commission direct the PSPs -- who are in a position to provide the necessary information -- to provide such cost data so that this calculation can be made.

17/ The court stated that "the critical point here is that the FCC has failed to justify tying the default rate to local coin rates; and the mere possibility that the default rate might be adjusted by negotiation does not negate the fact that it is arbitrary." Slip Op. at 16.

18/ Sprint Comments at 23.

19/ AT&T Reply Comments at 6.

II. THE INTERIM COMPENSATION OBLIGATION SHOULD BE ALLOCATED AMONG CARRIERS ON THE BASIS OF THEIR REVENUES EARNED FROM TOLL-FREE AND ACCESS CODE CALLS FROM PAY PHONES RATHER THAN TOTAL TOLL REVENUES

In the Pay Phone proceeding, the Commission concluded that the obligation to pay PSPs flat-rate compensation during the first year of the interim period should be based on total toll revenues of the IXCs with toll revenues exceeding $100 million per year.[20] The court remanded two issues affecting this decision: (1) the court concluded that the Commission had not established a nexus between total toll revenues and the number of pay phone-originated calls; and (2) the court held that the Commission erred in requiring payments during the first interim year only from IXCs with annual revenues greater than $100 million.[21]

Based on the remand, the FCC has asked whether it should include LECs that carry toll traffic among the carriers required to pay interim compensation. MIDCOM believes that the Commission should include as payors not only LECs that carry toll traffic but also IXCs with annual toll revenues below $100 million. The court expressed the view that carriers other than large IXCs were obligated to pay compensation during the first year of interim compensation. Therefore, any revenue threshold would be contrary to the remand order because the court invalidated the revenue threshold in general and not merely the threshold based on $100 million.[22]

20/ Pay Phone Order at ¶ 119.

21/ Slip Op. at 17. This issue does not affect either the second year of interim compensation or the permanent plan because compensation for both of those phases will be based on per-call tracking.

22/ However, if the Commission continues to use a revenue threshold to determine flat-rate interim compensation, MIDCOM urges the Commission to use 1996 revenues, which

The Commission has also requested alternative proposals to using total toll revenues in determining interim obligations. As noted above, the court determined that total toll revenues are not the proper allocator for the interim pay phone compensation obligation. MIDCOM believes that the approach that would fairly allocate pay phone compensation among payors is the revenue each payor earns from toll-free and access code calls placed from pay phones, as this revenue figure relates far more directly to the amount any IXC ought to expect to pay PSPs for the costs related to originating toll free and access code calls.[23/]

MIDCOM proposes the following procedures for determining the appropriate allocation among payors during the interim period. Any payors that are able to determine the number of access code calls and toll-free calls they receive each month from pay phones would submit their data to the Commission, along with their estimates of the average number of calls they would receive during the first year of the interim period. On the other hand, any payors that are not in a position to determine the number of these calls they receive from pay phones would submit a good-faith estimate of those calls. In turn, the PSPs would submit their calculations of the total number of toll-free and access code calls placed from their pay phones. The Commission would then reconcile those numbers and assess a percentage of the total monthly obligation owed by each payor during the interim period. The Commission's involvement in this manner would be

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would more closely correspond to the interim time period.

[23/] If the Commission continues to use full toll revenues as an allocator, then it should give all payors an option to pay first-year interim compensation on a per-call basis. The Commission has expressed its strong preference for compensating PSPs on a per-call basis. Carrier-payors should not be forced to pay compensation on a flat-rate basis during the interim period if they can track pay phone calls, or otherwise determine the number of calls they receive from pay phones.

temporary, as the recalculation is needed only to resolve the compensation for the first year of the interim plan (October 1996 to October 1997).

III. CONCLUSION

MIDCOM believes that the compensation rate for toll-free calls and access code calls should not be based on the local coin rate but instead on the actual costs of providing these calls. Indeed, the Commission is obligated under the terms of the court remand to take the costs for non-coin calls into account when determining the appropriate compensation rate. In such a reevaluation, MIDCOM believes the rate should fall between $0.25 and $0.067 based on data submitted during the proceeding. A more precise calculation could be achieved if the Commission directs the PSPs to submit the data necessary to determine the costs of providing these calls. MIDCOM urges the Commission to add as payors all IXCs and LECs that carry toll traffic. Finally, MIDCOM recommends that the pay phone compensation obligation be allocated among payors on the basis of toll-free and access code revenues received from pay phones, rather than total toll revenues.

Respectfully submitted,

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August 26, 1997

CERTIFICATE OF SERVICE

I, Cornelia R. DeBose, hereby certify that a copy of the foregoing *Comments of MIDCOM Communications, Inc. on Issues Related to Court Remand* was sent to the offices of the following via hand delivery this 26th day of August, 1997:

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